AMAX LEAD COMPANY OF MISSOURI
(ON RECONSIDERATION)

IBLA 84-194
84 IBLA 102 Decided October 29, 1987

Reconsideration of AMAX Lead Company of Missouri, 84 IBLA 102 (1984). Reaffirmed as modified.

1. Mineral Leasing Act: Royalties

When the mineral lease provides for such determination, the Minerals Management Service may properly determine to value zinc concentrates sold, for royalty purposes, on the basis of the highest price which the lessee would pay or receive pursuant to a contract with an unaffiliated supplier or buyer, if the contract under which the concentrates are actually sold is not a bona fide arm's-length transaction between independent parties.

APPEARANCES: Gerald A. Malia, Esq., and Linda J. Gyrsting, Esq., Washington, D.C., for appellant; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., Bruce W. Dannemeyer, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE MULLEN

This is a reconsideration of the Board's decision in AMAX Lead Company of Missouri, 84 IBLA 102 (1984). In that case AMAX Lead Company of Missouri (AMAX Lead) appealed from a decision of the Director, Minerals Management Service (MMS), dated August 26, 1983, concerning the valuation for royalty purposes of zinc concentrates mined by AMAX Lead as a lessee of Federal lands. The facts of the case and the rationale of our decision are set forth in detail in the Board's decision.

AMAX Lead advances four arguments for reversal of the Board's decision. These arguments are:

1. The Board arbitrarily overruled the key precedent of Getty Oil Co., 51 IBLA 47 (1980);

2. The Board failed to comply with Departmental regulations;

3. The Board ignored uncontroverted evidence contained in the Menconi Affidavit submitted by AMAX Lead as a part of its statement of reasons for appeal to the Board.

4. The decision has resulted in an arbitrary royalty scheme which penalizes affiliates and implements a "ratchet" technique which violates Departmental regulations and policy on royalties.

AMAX Lead and Homestake Lead Company of Missouri (Homestake) are joint venturers for the production of minerals from the leased property. Each owns an undivided 50-percent interest in the leases under review. Effective January 1, 1981, Homestake entered into an agreement for the sale of mine concentrates produced from the leased property to AMAX Lead and Zinc, Inc., which acted as agent for AMAX Zinc Company (AMAX Zinc). 1/ AMAX Lead then entered into an agreement for the sale and purchase of concentrates which is essentially identical to the Homestake contract. Both contracts ran for a term of 4 years. On November 24, 1981, but effective January 1, 1982, AMAX Zinc entered into a 3-year agreement with the St. Joe Lead Company (St. Joe) for the sale and purchase of all concentrates produced at two mines operated by St. Joe. 2/ Under the St. Joe contract AMAX Zinc paid a higher price for the concentrates than that paid for either Homestake or AMAX Lead concentrates. The MMS determined that, following the execution of the St. Joe contract, the royalty calculations for the AMAX Lead concentrates should be made on the basis of the St. Joe contract. Only those royalties for the period from November 24, 1981, through November 30, 1982 are in question.

[1] Appellant argues at length that the precedent in Getty Oil Co., supra, was overruled by the AMAX Lead decision. This is not the case. Rather, there are facts in this case which set it apart from the Getty Oil case. The essential difference is set forth in detail in the AMAX Lead decision at pages 110 through 111. In addition, a major difference between the royalty determination in Getty Oil and the case now before us is the nature and wording of the regulations governing the determination of the value of the product for royalty purposes. The regulation in effect for oil and gas at the time of the Getty Oil case stated:

> The Secretary of the Interior may establish reasonable values for purposes of computing royalty on any or all oil, gas, natural gasoline, and other liquid products obtained from gas, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to

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1/ AMAX Lead, AMAX Lead and Zinc, and AMAX Zinc Company are wholly owned subsidiaries of AMAX, Inc.
2/ Approximately 92,400 dry short tons per year.

> other relevant matters. In appropriate cases this will be done after notice to the parties and opportunity to be heard.

43 CFR 3103.3-4(d) (1980). 3/

The interpretation of the AMAX Lead lease provision governing the value basis for royalty computation becomes more evident if examined in light of the events which transpired at the approximate time the provision was made a part of the lease. The regulation in effect through April 11, 1978, reads as follows:

> § 231.61 Royalty basis.
>
> The sale price basis for the determination of the rates and amount of royalty shall not be less than the highest and best obtainable market price of the ore and mineral products, at the usual and customary place of disposing of them at the time of sale, and the right is reserved to the Secretary of the Interior to determine and declare such market price, if it is deemed necessary by him to do so for the protection of the interests of the lessor.

30 CFR 231.61 (1977).

Effective April 12, 1978, the language was amended to read:

> § 231.61 Value basis for royalty computation.
>
> (a) The gross value for royalty purposes shall be the sale or contract unit price times the number of units sold, provided however, That where the Mining Supervisor determines:
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> (1) That a contract of sale or other business arrangement between the lessee and a purchaser of some or all of the commodities produced from the lease is not a bona fide transaction between independent parties because it is based in whole or in part upon considerations other than the value of the commodities, or (2) That no bona fide sales price is received for some or all of such commodities because the lessee is consuming them, the Mining Supervisor shall determine their gross value, taking into account: (i) All prices received by the lessee in all bona fide transactions, (ii) Prices paid for commodities of like quality produced from the same general area, and (iii) Such other relevant factors as the Mining Supervisor may deem appropriate; and provided further, That in a situation where an estimated value is used, the Mining Supervisor shall require the payment of such

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3/ This regulation was modified in 1983, but the revision does not have bearing upon this case.

> additional royalties, or allow such credits or refunds as may be necessary to adjust royalty payment to reflect the actual gross value.
>
> (b) The lessee is required to certify that the values reported for royalty purposes are bona fide sales not involving considerations other than the sale of the mineral, and he may be required by the Mining Supervisor to supply supporting information. [Emphasis in original.]

30 CFR 231.61 (1980). See 43 FR 10341 (March 13, 1978). At the time of the regulation amendment, the applicable royalty value determination provision of the AMAX Lead lease stated:

> For the purposes of this lease, the gross value of the minerals mined hereunder at the point of shipment to market (hereinafter called the "Gross Value") shall, in the discretion of the Secretary of the Interior, be either of the following prices less transportation charges in effect at time of shipment from the place of origin of the concentrates referred to below to the smelter:
>
> (i) the highest price, if any, paid or offered the lessee for all or any part of the concentrates produced from ore mined under this lease, or
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> (ii) the highest price the lessee would pay for concentrates of substantially similar quality, if such price were determined by contracts then in effect between the lessee and any of its suppliers of concentrates, other than suppliers affiliated with the lessee;
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> If (i) and (ii) are inapplicable in the determination of Gross Value, such value shall be determined by the average posted New York metal price as quoted by the "E. & M.J. Metal and Mineral Markets" for the period prescribed in subsection (f) of Section 2 of this lease less an allowance for average freight and Federal taxes thereon from the treating smelter to Atlantic Seaboard destinations to which metal is customarily shipped by lessee and less all of the lessee's costs and charges during such period in connection with lessee's shipping, smelting, refining, handling and selling of all concentrates (other than those produced by lessee) and of all metal produced therefrom.

On June 2, 1978, less than 2 months after the effective date of the amendment to the regulation, the AMAX Lead lease was amended effective August 1, 1978, to read:

> For the purposes of this lease, the gross value of the minerals mined hereunder at the point of shipment to market

> (hereinafter called the "Gross Value") shall, at the discretion of the Secretary of the Interior, be either of the following prices less transportation charges in effect at the time of shipment from the place of origin of the concentrates referred to below to the smelter:
>
> (i) The price paid the lessee under arm's length contracts (bonafide transactions with independent parties) for all or any part of the concentrates produced from ore mined under this lease, or
>
> > (ii) When concentrates are processed for lessee's amount at its own (captive) or any other smelter, the highest price the lessee would pay or receive, whichever is greater, for concentrates of substantially similar quality, if such price were determined by contracts then in effect between the lessee and any of its suppliers or buyers of concentrates other than parties affiliated with the lessee.

See Decision of Chief, Division of Land and Minerals, dated June 2, 1978. There can be little doubt that the lease amendments were as a direct result of the amended regulation, and were intended to apply the new regulation to the AMAX Lead leases. This language remained in effect until amended, effective December 2, 1982.

Two important distinctions exist between this case and Getty Oil case. The first is the obvious language variance between the regulatory provision establishing the basis for calculating the value of the product for royalty purposes, and the second is the language of the AMAX Lead lease, which calls for an interpretation other than that applied in the Getty Oil case. Thus, an interpretation of the regulation and contract language in this case does not result in an overruling of the Getty Oil case.

The term "price paid the lessee under arm's length contracts" is not equivalent to "fair market price," the term crucial to the Getty Oil determination. See Getty Oil Co., supra at 51. Additional crucial facts in this case also distinguish this case from the Getty Oil case. In the Getty Oil case, Getty entered into a contract with a subsidiary for delivery of natural gas. That contract was reviewed by the Federal Energy Regulatory Commission (FERC) and determined to be reasonable, and FERC approved the contract. This contract was submitted to and accepted by MMS. Later in the "spot price" for gas increased and was higher than the price specified in the approved contract. However the oil and gas industry was regulated and Getty was bound by the terms of the FERC-approved contract. In order to increase the amount it would have received, Getty would have been required to seek approval of a rate increase from FERC. Getty was truly locked into the contract price. The facts, lease terms, and applicable regulations clearly make this case distinguishable from the Getty Oil case.

AMAX Lead alleges the majority opinion misunderstood the relevant provision of the lease. It argues:

> [T]he Board omitted a significant part of the clause when it stated that "clause 'i' is limited in its applicability to 'arm's length contract,' as that term is defined in clause 'i'." the focus of the clause is not limited to "arm's length contracts," but rather to the "price paid the lessee under arm's length contracts." The Board has failed to recognize this crucial distinction. By its decision, it has interpreted the lease in an overly narrow manner, thus failing to recognize that the price of the AMAX Lead/AMAX Lead and Zinc contract is the equivalent of a "price paid the lessee under arm's length contracts."

(Brief on Appeal to Secretary at 6-7 (footnotes omitted)). The basis for AMAX Lead's argument that the royalty amount should be based upon the AMAX Lead-AMAX Zinc contract is the fact that under this contract "the 'price' paid is the same as the price under the arm's length Homestake contract." They argue that the Board majority erred by omitting a significant part of the clause "i" when it determined, at page 107 of the decision, that clause "i" was limited to arm's length contracts. In doing so AMAX Lead attaches significance to the phrase "price paid the lessee under the arm's length contracts." (Emphasis added.)

As previously noted, the clause applicable to other cases is "price paid the lessee under arm's-length contracts (bona fide transactions with independent parties)." As we indicated in our previous opinion, the AMAX Lead-AMAX Zinc contract cannot be regarded as falling within this clause because the parties are not independent as they are both subsidiaries of AMAX, Inc. 4/ The only reason the royalty basis was the same as that expressed in the AMAX Lead-AMAX Zinc contract before the St. Joe-AMAX Zinc contract became effective is that royalty basis established in the Homestake-AMAX Zinc contract, a contract that can be regarded as an arm's-length contract between independent parties. Stated in another way, it was royalty to be paid by AMAX Lead before the St. Joe-AMAX Zinc contract; the AMAX Lead-AMAX Zinc contract was irrelevant to that determination because it was not a contract between independent parties. Just as the FERC constraints on the contract price between subsidiaries in Getty Oil served to confirm that price was a fair market price, the Homestake-AMAX Zinc contract price served to confirm that the AMAX Lead-AMAX Zinc contract price was the highest price then obtainable for the concentrates involved. However, when the St. Joe-AMAX Zinc contract came into effect it served as the basis for a determination that the previous price was no longer the highest price under an arm's-length contract.

To further highlight the importance of this distinction, let us assume that, for tax purposes, management of AMAX, Inc., the parent company, concluded that the mining operation should show a profit and the smelting operation should show a loss. AMAX Lead and AMAX Zinc could enter into a

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4/ See a further discussion of the effect of this fact in the discussion of the "ratcheting" argument.

"sweetheart" contract and argue that paragraph (i) should not apply, because the contract was not made at arm's length. In such case, under paragraph (ii) the Homestake contract would be applicable. If MMS disagreed, the AMAX parent officers could direct that the "sweetheart" contract be cancelled. 5/ Likewise, at any time after it had entered into the contracts with Homestake and St. Joe, AMAX, Inc., could choose to direct the officers of its subsidiary St. Joe contract. 6/ It therefore can be seen that the provisions of the lease pertaining high royalty) became of a corporate decision to shift corporate income from one subsidiary to another. Thus, because AMAX, Inc., could amend its subsidiary contracts at any time, the lease language was drafted to provide for the value of the minerals produced based upon "the highest price" AMAX would receive at the time of royalty calculation for concentrates of a substantially similar quality. AMAX Lead places great emphasis on the fact that AMAX Lead smelter contract was equivalent to the Homestake smelter contract. However, we can find no word or phrase in paragraph (i) which would allow an interpretation of that paragraph requiring MMS to accept a non-arm's length contract merely because it is equivalent to one that is. Using the logic advanced by AMAX Lead and Judge Burski, and assuming arguendo the St. Joe contract resulted in lower payments, AMAX could void its earliest contract and adopt the terms and conditions of the lower-paying contract. In such case the new contract would also be equivalent to an arm's length contract, and, using their logic, MMS would be bound by its terms. We think not. The end result would be a "ratcheting" similar to that which concerns AMAX Lead and Judge Burski, with one major difference: the royalty amount would constantly be ratcheted downward to the lowest price represented by an arm's length contract. The lease language was formulated to address this line of thinking.

AMAX Lead admits, that in order to "break" the Getty Oil contract, Getty would be required to seek and obtain FERC approval, and that, conversely, AMAX Lead would not. In doing so, they assume the AMAX Lead-AMAX Zinc contract was the basis for the royalty determination. Under the lease provisions it was not. The only reason that AMAX Lead-AMAX Zinc provisions would seem to apply was that, when calculating the royalty amount, the result was the same as that

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5/ AMAX, Inc., the parent corporation, has the ability to direct both AMAX Lead and AMAX Zinc to rescind the contract. It is important to note that, because the AMAX Lead-AMAX Zinc contract is not an arm's length contract, it would also be inappropriate for MMS to look to the AMAX contract, even if, on its fact, it appeared to represent a higher price than the highest priced arm's-length contract. This is discussed further in the discussion of ratcheting.

6/ Ignoring for the moment the real effect of the royalty calculations on the income received by AMAX, Inc., it can be seen that any adjustment in the smelter contract between the subsidiaries would have no effect upon the income received by the parent. It merely shifts the income from one subsidiary pocket to another.

result was the same as that based on the Homestake contract. AMAX Lead is not required to "break" its contract with AMAX Zinc. It merely has to calculate the royalty payable to the Government on a different basis in compliance with the lease terms.

Appellant argues this Board failed to comply with 43 CFR 231.61, as amended in 1978 in response to an April 1976 policy decision by Secretary Kleppe. See 43 FR 10341 (Mar. 13, 1978); 41 FR 54003 (Dec. 10, 1976). In the April 1976 policy decision, Secretary Kleppe indicated a preference for determining royalty on the basis of actual prices received by the lessee in all bona fide transactions not involving considerations other than the sale of the mineral rather than on the basis of the highest and best attainable price, which had been the basis under the regulations before amendment. See 30 CFR 231.61 (1977); 43 FR 10341 (Mar. 13, 1978). Appellant argues that our decision "retreats to the pre-1976 policy. Instead of basing the mineral valuation on the 'actual price' of the AMAX Contract, the Board has ignored the Department's policy and based the valuation on the emergency St. Joe Contract." Appellant is mistaken. As explained above, the AMAX Lead-AMAX Zinc contract cannot serve as the basis for determining the royalty because it is not a contract between independent parties. Our decision affirmed a determination that the actual price that should be the basis for the royalty was the price of set forth in St. Joe-AMAX Zinc contract. Employing this contract as that basis is not a reversion to the policy or practice of basing royalty on "posted" or "spot" prices followed before the regulations were amended.

It is important to note that all of the smelter contracts before us provide for payment on settlement based upon a gross value of the concentrates derived from the average quoted market price for the product for a stated period of time prior to settlement. Thus, the price paid under all of the smelter contracts is directly dependent upon the world market price of the metals. The argument that the Board looked to the "posted prices rather than actual prices" clouds rather than clarifies the issue. The "posted spot prices" are, in fact, the basis for value determination in all of the smelter contracts under review, and are not in issue. What is in issue is the proper basis for determining the portion of the "posted spot price" which may be deducted as a smelter charge when calculating the value of the product for royalty purposes. The Homestake and AMAX Lead contracts differ from the St. Joe contract, not on the basis of the gross value of the metals produced, but upon the basis of a difference in the amount deducted from the gross value for treatment. In effect, therefore, all three contracts are "ratcheted" up and down as a result of the change in world-market prices. However, once a contract is executed, the "smelter charges" remain relatively unchanged, regardless of the world market conditions. 7/ As can be seen a form of "ratcheting" is built into all three smelter contracts.

7/ In Getty Oil Co., supra, the contract price was fixed and MMS sought to have the royalty based upon the "spot price" which was higher. Spot price is similar to world market price. The only change in the dollar amount of the "treatment charges" in the smelter contracts resulting from changes in

AMAX Lead and the dissent in the earlier opinion express concern that the majority view results in an additional "ratchet effect" which would cause the royalty to be continually increased. This would be true only if the AMAX Lead smelter contract were considered to be binding for determination of royalties. For royalty purposes the AMAX Lead smelter contract is binding on neither AMAX Lead nor MMS. This being the case, any "ratcheting effect" over which AMAX expresses concern is in the sole control of AMAX, as it is dependent upon those arm's-length contracts entered into by AMAX.

By way of illustration, the following simplified example is given. At the beginning of year one the highest arm's-length contract results in a $1 per unit payment. This contract (contract A) runs for a term of 5 years. The mining subsidiary of the smelter company enters into a smelter contract with terms identical to those in contract A shortly after contract A is executed. At the beginning of year two, the smelter enters into an arm's-length contract with an independent party (contract B) which runs for 2 years and results in a $1.50 per unit payment. At the end of its term contract B is not renewed. The royalty would be based on the following unit values: Year 1, $1.00; years 2 through 3, $1.50; and years 4 and 5, $1. Thus, it can be seen that the royalty base can move both up and down, based upon supply and demand, with the basis for determination being what the smelter is willing to pay in an arm's-length transaction.

In the case before us, the price paid to the mine is based upon the world-market price. The only thing at issue is the charges and deductions assessed against the product for treatment. Changes in the smelter charges are not as a direct result of changes in the world-market price of the metals produced but as a result of the changes in supply and demand for the concentrates to be treated. Thus, if, at the time of contract negotiations, a number of mines have concentrates to sell, and there is little smelter capacity, the smelter can charge more for its services. On the other hand, if smelter capacity exceeds supply, the smelter must bid against other smelters, resulting in lower smelter charges.

AMAX Lead argues that the Board ignored the Menconi Affidavit and, as a result, committed a reversible error. In support of this stance AMAX Lead has attached the Menconi Affidavit to its statement of reasons and quoted the following passage:

> In late 1981, major strikes at seven mines and the closing down of three others contributed to temporary world-wide shortages of zinc concentrates. In the last six months of 1981, the

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fn. 7 (continued)
metal prices is the value of the "unit reduction" of the amount of metal in the concentrate. For example, a typical contract will pay for only certain percentage of the metal contained in the concentrate. Historically this reduction is justified by the smelter as a deduction which is reflective of the smelter's recovery rate.

> workers at an additional mine went on strike causing an even greater shortage. The normal operating capacity for the AMAX Zinc refinery in 1981 was about 150,000 short tons. As a result of the strikes, however, we faced a sudden shortage of about 40,000 short tons of zinc for 1981. AMAX Zinc was confronted with the decision whether to shut down the zinc refinery, have a large cut-back in production, or somehow obtain a limited amount of incremental supplies of zinc in late 1981.
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> Shutting down the refinery would have severely worsened the already high unemployment levels in Sauget, Illinois and surrounding communities, which in late 1981 were experiencing precarious economic conditions. Closing the refinery would have meant the loss of over 300 jobs. Cutting back would have meant the loss of at least 80 jobs. About twenty-five percent of the Sauget refinery employees lived in East St. Louis, which at the time had one of the highest unemployment levels in the country. Additionally, either a shut-down or a cut-back would have caused even further unemployment in the local service industry.
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> Under this combination of extraordinary circumstances, and in an effort to avoid the dire consequences of a shut-down or cut-back, AMAX Zinc agreed to an emergency contract with St. Joe for an incremental supply of zinc concentrates.

(Statement of Reasons on Appeal to the Secretary, at 3-4.)

As can be seen, the conclusion drawn by AMAX Lead is that the price paid to St. Joe for its concentrates is somehow not representative, and thus should not be used. However, when examined in light of the other documents in the file and the state of the industry at the timer, we cannot draw the same conclusion. In fact, we find the Menconi document supports our conclusion.

As noted previously, the smelting industry, like other unregulated industries, is subject to changing market conditions and is thus directly affected by the law of supply and demand. 8/ In order to make a determination whether the difference between the Homestake contract and the St. Joe contract is a result of "extraordinary circumstances" or a "change in market conditions," one must look to market conditions as well as the state of the operations at the particular smelter. We note the following factors, as reported in the Minerals Yearbook, which we also consider to be important: 1) the strike mentioned in the affidavit lasted 72 days and was settled prior to the end of 1981; 2) United States smelter capacity increased in 1981; 3) In 1981 the AMAX smelter treated record levels of concentrates; 4) the Monaca, Pennsylvania, smelter was reactivated with increased smelter capacity;

8/ Deregulation of the oil industry and resulting fluctuation in prices illustrates this point.

5) Zinc production at Corpus Christi was up 10 percent; 6) National Zinc's Bartlesville, Oklahoma, plant was able to reach its designed capacity; 7) in spite of the "world wide shortage," domestic zinc production fell less than 4,700 metric tons, or less than 1-1/2 percent. 9/

On the other hand, a number of zinc mines closed in 1982, and U.S. production of recoverable zinc was only slightly less than 1981 production. Asarco's Corpus Christi plant operated at 50-percent capacity from February to October and closed in October 1982. St. Joe again increased its capacity in Monaca, Pennsylvania. 10/

We cannot agree with AMAX Lead that the increased payment to St. Joe was a direct result of the strike. The strike had been settled by January 1, 1982, when the 3-year St. Joe smelter contract took effect. The duration of the St. Joe contract causes us to believe that the contract was entered into in contemplation of long-term supply and demand factors, rather than as a short-term, stop-gap measure designed only to supply concentrates during a strike period.

One additional aspect of the Menconi Affidavit gives us pause. Menconi states:

> As a result of the strikes, however, we faced a sudden shortage of about 4,000 short tons of zinc for 1981. AMAX Zinc was confronted with the decision whether to shut down the zinc refinery, have a large cut-back in production, or somehow obtain a limited amount of incremental supplies of zinc in late 1981. (Emphasis added.)

However, the St. Joe contract called for delivery of "the entire annual production from two mines operated by St. Joe" for a period commencing January 1, 1982." [Emphasis added.] This was neither a "limited amount" nor "supplies of zinc in late 1981." The St. Joe contract, the world-market conditions, and the recognition in the Affidavit that there were shortages of zinc concentrates in the fall of 1981, clearly indicate these "shortages of concentrates" can be more aptly defined as "excess smelter capacity." It was a seller's market.

Even if we were to accept the reasoning expressed in the Menconi Affidavit, we would find it hard to accept the sought-after results. It appears that if taken literally, AMAX argues it is fair and acceptable for AMAX to pay additional amounts to St. Joe to keep the smelter operating, but that there is some reason that it would be unfair to expect AMAX to pay an increased royalty to the United States to achieve the same results. It may be that the increased royalty was not contemplated when AMAX Zinc entered into a contract with St. Joe. If so, the failure to do so was an error which resulted in higher royalties than anticipated. However, there is no reason

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1/ "Zinc," Minerals Yearbook 1981, Vol. I, 893-919.
2/ See "Zinc," Minerals Yearbook 1982, Vol. I, 897-925.

expressed in the affidavit which would be a proper basis for expecting the royalty basis to remain unchanged.

Notwithstanding our conclusions, we do perceive one error in our prior decision. We affirmed the decision to assess royalties based on the St. Joe contract commencing November 24, 1981. Upon further review of the St. Joe contract we find it inappropriate to do so. The effective date of the St. Joe contract was January 1, 1982. Thus, the St. Joe contract should be used as the basis for determining royalties for the period from January 1, 1982, through November 30, 1982, not from November 24, 1981, through November 30, 1982. AMAX Lead Company of Missouri, supra, is hereby modified to reflect that change, but affirmed in all other respects.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the Board's prior decision in the matter, reported at 84 IBLA 102 (1985), is hereby reaffirmed as modified by this decision.

R. W. Mullen
Administrative Judge

I concur:

Will A. Irwin
Administrative Judge

ADMINISTRATIVE JUDGE BURSKI DISSENTING:

The majority, in essence, reaffirms the conclusion which was reached in the original decision herein, AMAX Lead Company of Missouri, 84 IBLA 102 (1984), that the Director, Mineral Management Service (MMS), correctly held that AMAX Lead Company of Missouri (AMAX Lead) must recalculate royalty payments made subsequent to January 1, 1982, 1/ on the basis of prices paid under a contract entered into on November 24, 1981, between St. Joe Lead Company (St. Joe) and AMAX Lead & Zinc, Inc. (AMAX Lead and Zinc). In doing so, both this Board and the Director, MMS, necessarily determine that the contract between AMAX Lead and AMAX Lead & Zinc does not establish fair market value after that date, even though a co-lessee (Homestake) will continue to tender royalties on the exact same basis as that provided in the contract between AMAX Lead and AMAX Lead & Zinc. I thought at the time of our original decision, and I continue to believe today, that the reasoning behind this result is inherently flawed, both as a matter of regulatory interpretation as well as economic theory. Accordingly, I would grant the instant petition, vacate the decision of the Board, and reverse the decision of the Director, MMS.

In our prior decision, I set forth my views at some length. See AMAX Lead Company of Missouri, supra at 114-18 (dissenting opinion). I will not repeat that entire analysis here. Rather, I wish simply to reiterate my conclusion that the ultimate result of this case is indefensible as a simple matter of logic. Thus, we have a situation in which there exists two Federal co-lessees mining the same deposit who both enter into an agreement with the same smelter which results in the same payments to each. The majority concludes that, while this contract establishes the fair market basis for Federal royalty calculations for one of the co-lessees (Homestake), it does not do so for the other (AMAX Lead), solely because AMAX Lead and the smelter are separate corporate subsidiaries of the same parent corporation.

The majority justifies its approach on the theory that, while the Homestake contract constituted "the highest price the lessee would pay or receive * * * for concentrates of substantially similar quality" from January 1, 1981, to January 1, 1982, the St. Joe contract constituted "the highest price the lessee would pay or receive" after January 1, 1982. The problem I have with this analysis is that it conveniently ignores all variables in a contract other than price and affirmatively penalizes any corporate subsidiary or affiliate which contracts with any other subsidiary or affiliate.

Thus, the price which Homestake obtained from AMAX Lead & Zinc was not solely based on contemporaneous sales in the spot market but necessarily took into consideration the duration of the contract. Any long-term contract

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1/ The majority does modify its prior decision to the extent that it affirmed the assessment of royalties based on the St. Joe contract commencing on November 24, 1981. It now concludes that the operative date of the royalties should be January 1, 1982, since that was the effective date of the St. Joe contract.

involves consideration of not only the present market value of a commodity but also an additional factor involving allocation of the risk for possible price movement. If the perception is that the price of a commodity is likely to fall over the duration of a contract, then the risk factor allocation is likely to result in a unit price below the spot market price. If, on the other hand, the parties believe that the commodity price is likely to rise, it is also likely that a long term contract will result in initial payments in excess of the spot market valuation.

Moreover, the nature of the market, itself, may result in either a premium or a lower value being put on long-term arrangements. Thus, if the nature of the marketplace is such that smelters are constantly in search of deposits to keep their operations going, a smelter might pay a higher unit price in exchange for a contract which insures a constant supply for a longer period of time. On the other hand, if there exists a shortage of smelting operations, the seller of the raw product might elect to take a lesser unit value in exchange for the assurance that it will encounter no difficulties in getting its ore beneficiated. In effect, either party or both parties may eschew the possibility of favorable future market movements in exchange for the certainty of either a ready market or an assured supply at a pre-arranged price.

Both the majority decision and that of the Director, MMS, ignore all these variables and focus exclusively on the price. This fatally comprises the entire process precisely because the price received under long-term contracts is the end result of the numerous variables which are being factored out. This approach also leads to the ludicrous result wherein Homestake is assessed royalty for its half of production on one basis while AMAX (which has entered into the exact same arrangement with AMAX Lead & Zinc) is required to tender royalties on the other half at a higher rate. Technical and inventive interpretation of regulations cannot hide the fact that this simply isn't logical or fair. I fail to see how such a result can be anything but arbitrary and capricious.

If the majority believes that the Homestake contract correctly determined fair market value when it was entered into, all of the relevant provisions (including contract duration) should be applied to AMAX Lead's production. Because the majority, in effect, picks and chooses those parts it wishes to apply, I respectfully dissent.

James L. Burski
Administrative Judge